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SUBJECT: CENTRAL BANK CUTS POLICY RATE TO HISTORIC LOW

¶1. Summary: On April 16, the Central Bank of the Republic of Turkey (CBRT) announced the Monetary Policy Committee cut its overnight borrowing rate to 9.75% from 10.50% and its overnight lending rate to 12.25% from 13.00%. Policy rate cuts since November 2008 have totaled 700 basis points (bp) and, for the first time since the 1960s, the overnight rate eased to single digits. Economists expect CBRT will continue rate cuts to bring down market interest rates, which should help to boost economic activity in Turkey. End summary.

¶2. The CBRT Monetary Policy Committee (MPC) held its monthly meeting April 16 and announced a 75 basis point rate cut in its policy rates, higher than the 50 bp market expectation. The MPC cut its benchmark rate (overnight borrowing rate) to 9.75%, which is a level not seen since the 1960s. Market economists such as Yarkin Cebeci from JP Morgan and Baturalp Candemir from EFG Istanbul expect rate cuts to continue, especially after recent jumps in unemployment, which increased to 15.5% in January 2009 with 3.6 million unemployed, up 1.1 million year on year. Industrial output was also weak, dropping 23.7% in February 2009. The government revised downward its real GDP growth assumption for 2009 from plus 4% to a much more realistic minus 3.6% on April 13, which also may have factored into the CBRT's decision. Earlier this week, CBRT Governor Durmus Yilmaz expressed concern over the gloomy economic outlook.

¶3. In the note released with the rate decision, CBRT signaled further rate cuts, which might come in smaller increments. CBRT said that the slowdown in economic activity will continue, since there has been no concrete sign that global recovery has begun. Downward pressure on inflation will continue since economic recovery will take time, and future rate cuts may be more measured. The Central Bank stated that downward flexibility in monetary policy is likely to remain for the foreseeable future. The CBRT also took into account the Turkish Lira's stability over the last month and limited negative effects from foreign exchange weakness early in 2009.

¶4. Comment: Although the rate cuts were slightly more robust than expected, markets were not rattled. The bond market began pricing in this rate cut at the beginning of the week (April 13) and government bond rates hit a compound annual level of 12.5% in the secondary market. On April 17, rates dropped to 12.38% following the MPC announcement. Bank lending rates are still high and range from 20-70% depending on the type of loan and the borrower, but we expect CBRT rate cuts will force down commercial market rates, and act as a key catalyst for growth in the second half of 2009. End comment.

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